CLEVELAND PUBLI. LIBRARY
BUSINESS INF. BUR.
CORPORATION FILE

RJR Quarterly Report 3

TO STOCKHOLDERS OF R.J. REYNOLDS INDUSTRIES, INC. THIRD QUARTER 1977

R.J. Reynolds Tobacco appoints Hunter president

Morgan V. Hunter has been elected president and chief operating officer of R.J. Reynolds Tobacco Company.

Hunter, 48, had been a senior vice president with American Cyanamid Company.

Wm. D. Hobbs, 61, who had been president of the Tobacco Company, will remain as the subsidiary's chairman and chief executive.

Initially, Hunter will have direct responsibility for Reynolds Tobacco's marketing, marketing research, sales and research and development functions.

"Morgan Hunter's broad experience in the marketing and sale of consumer products will prove very valuable in keeping R.J. Reynolds the leading company in today's extremely competitive tobacco industry," Hobbs says.

Hunter

Hobbs

At American Cyanamid, Hunter was a member of the executive committee and responsible for the company's consumer products (Shulton) and corporate development and planning divisions.

Before that, Hunter had been with Procter & Gamble Co. for 18 years, holding a succession of management posts in advertising and marketing, and then heading the P&G-owned Folger Coffee Co.

Hunter is a native of Elk City, Oklahoma, and a 1953 graduate of the University of Oklahoma.

World Headquarters in operation

The R.J. Reynolds Industries, Inc. World Headquarters in Winston-Salem is now occupied and in operation. More than half of the 1,000 employees who will be assigned within the World Headquarters' ten acres of office space are now at their stations. Reaction by employees has been favorable to the environment, that features an "open landscaping" interior design employing multi-height partitions to give occupants both privacy and a sense of spaciousness.

RJR Archer sells gift wrap business

RJR Archer, Inc. has announced the sale of its Consumer Division's gift wrap, ribbons and bows facilities in Greeneville, Tenn., and Carlstadt, N.J., to American Greetings Corporation. The price of the sale was not disclosed.

Carroll G. Tompson, president of the RJR subsidiary, says Archer will continue to operate the business until the end of the year to fulfill customer commitments.

"We are very pleased this sale could be worked out to preserve the jobs in these two locations and to avert any detrimental economic effect on the two communities," Tompson says.

(Continued on page 2)

Net earnings, sales continue to climb

Net earnings of R.J. Reynolds Industries, Inc. increased 13 percent to $103.5 million or $2.00 a fully diluted share in the three months ended September 30, compared with a year earlier. Sales and revenues rose 8.4 percent to $1.6 billion.

Nine-month net earnings were up 11 percent to $291.6 million or $5.65 a fully diluted share. Sales and revenues rose 16 percent to $4.8 billion.

Financial report begins on page 4.

Aminoil nears geothermal steam

Aminoil USA moved to the threshold of its first geothermal steam production when the company recently joined Pacific Gas & Electric Company to honor the construction start-up of PG&E's newest steam-powered generating plant near San Francisco.

Steam erupts at The Geysers field.

The power plant will be the first commercial use of steam from Aminoil's sources in The Geysers field in northern California. The 135-megawatt power plant is the largest steam-powered generating facility of its kind ever to be built.

When the $60 million project is completed in July, 1979, the plant will be able to produce enough power to satisfy the needs of a city of 200,000.

Aminoil USA is committed to providing three million pounds of steam per hour for operation of the plant.

Aminoil USA has been a pioneer in the geothermal field, first entering exploration in the mid-'60s. The Geysers, a dry steam field, is the company's main development area, and is expected to someday yield enough power to handle an electricity demand matching the needs of half of New York City.

International board expanded

Peter G. Williams and Dr. Carlo Bombieri have been appointed to the International Advisory Board of R.J. Reynolds Industries, Inc.

Williams, a native of Great Britain, has broad international business experience. He is chairman of Inchcape (Hong Kong) Ltd., a diversified international trading company, and also serves on the board of directors of some 30 companies that operate around the world.

Dr. Bombieri is the retired managing director of Banca Commerciale Italiana, Milan, one of the largest banks in Italy, and currently serves as a director or officer of a number of European financial and manufacturing companies.

"With their extensive experience in foreign business operations, these two men will make a valuable contribution to our Advisory Board as we continue to expand our foreign involvement," says Colin Stokes, R.J. Reynolds Industries chairman.

The International Advisory Board was created in 1974 to enable R.J. Reynolds Industries to benefit from the expertise of prominent world business leaders. Members of the board advise the Company on international policy and operations.

Taco Reál put in test markets

Taco Reál, an authentic, Mexican-style taco, has been introduced in three major market cities by RJR Foods, Inc.

Taco Reál represents the first complete taco offered in supermarkets. The product has a crisp shell, a special beef, bean and cheese filling, and sauce mix packet in a single package.

A special package has been designed for Taco Reál, to prevent the taco shells from breaking.

Supermarkets in Houston, Oklahoma City and Sacramento began offering Taco Reál in their frozen food sections in October.

RJR Archer sale

(Continued from page 1)

The sale does not include Archer's florist foil business, which will be moved to Winston-Salem before year-end.

Archer announced earlier this year it was seeking a buyer for its major Consumer Division operations, to allow the company to concentrate in areas of growth more compatible with its long-range objectives.

Long-term growth sought for Real

Real cigarettes, one of the newest low "tar" entries of R.J. Reynolds Tobacco Company, have achieved an estimated .5 percent share of the U.S. cigarette market after four months in national distribution.

"Growth of Real has been slower than anticipated in our projections prior to the brand's introduction, but we feel this is due primarily to conditions existing in the market rather than any weakness in the product," says Charles A. Tucker, Tobacco Company group vice president and director of marketing.

Real's performance has been affected by "cluttering" of the low "tar" market with new brands, as well as by increased advertising and promotional activity by existing brands, he says.

"Our goal with Real is to market a brand which would provide long-term growth, and we feel Real will meet this objective," he says. "A nationwide test among smokers of both full-flavor and low-'tar' brands has clearly demonstrated that Real is a superior product in terms of tobacco taste and flavor."

An extensive new magazine and newspaper ad campaign has been mounted by RJR to make known the results of the taste test nationwide.

Stock car racing and drag racing are big promotion vehicles for RJR's Winston cigarettes in the United States, but in Hong Kong the brand rides on popularity of the annual dragon boat races. R.J. Reynolds Tobacco International, Inc., has sponsored teams in races all over Hong Kong. The company also set up Winston banners, distributed sample Winston cigarettes and presented Winston trophies.

Production slated for Aminoil well

An offshore Louisiana discovery well partly held by Aminoil USA has been tested to possess enough oil and natural gas to call for production drilling.

Tests of two zones of the well showed them capable of producing at a combined rate of 1,925 barrels of oil and 1.4 million cubic feet of gas a day.

Production from the block, which is 10 miles off Louisiana, is scheduled to begin in mid-1978.

Aminoil holds 4.5 percent interest in the venture.

Hawaiian Punch to new heights

The first American expedition to attempt to climb Manaslu, the world's seventh highest mountain, has selected Hawaiian Punch Drink Mix as a major part of its diet.

The 26,760-foot Himalayan peak has claimed the lives of 18 mountain climbers over two years, but the American expedition hopes Hawaiian Punch Drink Mix will help avoid one of the dangers — mountain sickness.

"Hawaiian Punch Drink Mix is significantly less acidic than most other drinks and that appears to be critical in the prevention of mountain sickness," says Dr. Charles F. Clark, deputy leader of the U.S. group.

RJR Foods, Inc. donated 400 pounds of various flavors of Drink Mix to the expedition's attempt to scale Manaslu, which is located in Nepal near the Chinese border.

The American Himalayan expedition is set to begin next March and last four months.

Sea-Land ventures succeeding

Encouraged by success in its new ventures into the Middle East and developing countries, Sea-Land Service, Inc. is planning to enter the South American trade.

The RJR shipping subsidiary expects to initiate bi-weekly containership service between the United States and Brazil and Argentina by mid-1978.

Sea-Land has become the leading containership carrier in the Middle East in its first year of operation there, following intensive development of Persian Gulf markets.

The success of its Middle East weekly containership service has prompted Sea-Land to launch plans for direct service between Middle East and Far East ports. The new service is expected to be underway by January 1978.

Sea-Land currently serves some 140 ports throughout the world.

Report from the Chairman and President

Colin Stokes

J. Paul Sticht

R.J. Reynolds Industries, Inc. reported third-quarter net earnings of $103.5 million for the three months ended September 30, a 13 percent increase from $91.8 million reported a year earlier. Fully diluted earnings per share increased 11 percent to $2.00 from $1.80. Sales and revenues increased 8.4 percent to $1.6 billion from $1.5 billion a year ago.

Net earnings for the nine months ended September 30 totaled $291.6 million, up 11 percent from $263 million reported a year earlier. Fully diluted earnings per share rose 9.7 percent in the nine-month period to $5.65 from $5.15. Sales and revenues totaled $4.8 billion, up 16 percent from $4.2 billion a year ago.

The domestic and international tobacco businesses made the major contributions to the third-quarter earnings increase, and foods and beverages as well as aluminum products and packaging experienced substantial increases in earnings from operations, compared with year-ago performance.

For the nine-month period the domestic and international tobacco businesses and the transportation business were the leading contributors to the corporate improvement.

Net foreign exchange losses, realized and unrealized, had the effect of increasing earnings by 9 cents per fully diluted share in the third quarter and 22 cents per fully diluted share in the nine-month period, compared with the same periods of last year.

The Company has arranged an offering outside the United States of $160 million of 7½ percent five-year notes to replace approximately $150 million long-term debt payable in deutsche marks. This would have the effect of reducing foreign currency gains and losses in future periods.

Late in the third quarter the Company repurchased the approximate $200 million balance of the production payment previously sold to a group of banks in 1976 as part of the financing of the acquisition of the Burmah Oil properties. The result of this transaction will be to reduce the Company's continuing net interest costs.

Our strong performance for the first nine months of 1977 reflects strong performance across our businesses and indicates we will have another full year of healthy growth in 1977.

Fourth-quarter performance, however, will be negatively affected by the International Longshoremen's Association strike that effectively closed our containership operations on the East and Gulf coasts beginning October 1. Although a tentative settlement subject to ratification by membership has been reached, we at this time cannot predict what total impact the strike will have on fourth-quarter earnings.

Domestic Tobacco

Sales of the domestic tobacco business increased 8.3 percent in the third quarter to $740.5 million, while earnings from operations (EFO) increased 5.4 percent in the third quarter to $149.8 million. Nine-month sales were up 6.9 percent to $2.1 billion, while EFO rose 8.7 percent to $437.5 million. The sales and EFO gains came mainly from price increases, which coupled with volume gains more than offset higher costs, most notably marketing expenses associated with the introduction of the company's Real brand.

International Tobacco

International tobacco sales increased 15 percent to $321.4 million in the third quarter, while EFO was up 66 percent to $22.4 million from the year-ago period. Nine-month sales rose 14 percent to $938.1 million, while EFO rose 68 percent to $67.6 million.

Gains in sales and EFO in both periods were attributable to higher unit volumes and price increases that more than offset higher operating costs. Heavy export shipments in anticipation of the longshoremen's strike and a mid-September cigarette price increase had a significant favorable impact on third-quarter performance, which in turn is expected to reduce shipments in the fourth quarter.

Transportation

Third-quarter revenues in the transportation business were up 10 percent to $249.8 million, with the increase due primarily to volume gains in the Atlantic, Middle East and Pacific trades. EFO rose to $44.8 million in the quarter, a 2.2 percent increase over third quarter 1976, which was by far the strongest quarter of 1976 for Sea-Land.

Nine-month revenues rose 13 percent to $706.3 million, while EFO was up 12 percent to $108.1 million.

Domestic Petroleum

Sales from domestic petroleum operations in the third quarter rose 13 percent to $114.9 million, while there was a $6.7 million EFO loss. Third-quarter EFO was affected by some hurricane-caused production losses in the Gulf of Mexico and higher costs — a part of which are of a nonrecurring nature. For the nine-month period sales increased to $410.1 million and EFO increased to $5.6 million, with the gains resulting principally from the Burmah Oil properties purchased at midyear 1976 and not included in the results for the first six months of 1976. Exploration spending in the domestic petroleum business continues at a high level.

International Petroleum

Third-quarter sales from international petroleum operations declined 11 percent to $108.2 million, while EFO fell 17 percent to $6.7 million. In the nine-month period sales increased 5 percent to $382 million, while EFO was down 54 percent to $12 million because of higher costs.

As previously reported, the Company's petroleum business in Kuwait was nationalized by the Government of Kuwait on September 19. Sales of the nationalized business were $244.4 million for the nine-month period, while EFO was $11.9 million. EFO of the Kuwait operations had been declining in recent years, principally because of provisions for higher royalty and tax assessments by the Government of Kuwait. The nationalization decree provides, among other things, for the formation of committees to assess compensation due to the Company and obligations it may have to the government.

No meetings concerning compensation have yet been held and the Company therefore cannot predict the impact of the nationalization on its financial position. However, the Company does not foresee any significant adverse effect on its earnings as a result of the nationalization.

Foods and Beverages

Third-quarter sales of the foods and beverages business were up 2 percent to $62.4 million, while EFO more than doubled to $5.7 million. The increase in EFO was primarily attributable to a more normal level of marketing expenditures for the company's Drink Mix line. Sales in the nine-month period rose 4.5 percent to $213 million, while EFO was up 20 percent to $16.9 million. About two-thirds of the nine-month sales increase came from volume gains, with the remainder from higher prices. EFO in the nine-month period benefited from the price and volume gains as well as manufacturing efficiencies and lower third-quarter costs.

Hawaiian Punch Drink Mix and ready-to-drink and Chun King Oriental foods contributed to improved performance in both periods.

Aluminum Products and Packaging

The aluminum products and packaging business recorded sales of $45.4 million in the three months ended September 30, up 11 percent from the year-ago figure. EFO was up 52 percent in the period to $4 million. Price increases accounted for about 60 percent of the sales gain, with increased volumes accounting for the remainder. Price and volume gains were sufficient to offset operating-cost increases.

Sales in the nine-month period were up 14 percent to $133.5 million, while EFO rose 26 percent to $10.9 million. The sales increase was attributable about equally to volume and price increases, which were sufficient to offset higher operating costs.

Non-Operating Items

Interest and debt expense for the first nine months of 1977 increased approximately $19.8 million over the comparable prior-year period, primarily as a result of interest expense on borrowings the Company obtained to finance the June 30, 1976, acquisition of the former Burmah Oil properties. Other income increased approximately $7.5 million and $8.0 million for the third quarter and first nine months of 1977, respectively, when compared to the prior-year periods. The improvement was primarily due to increased interest income from short-term investments and the payment in third quarter 1976 of $4.5 million in final settlement and termination of the Company's contractual obligations in connection with the U. S. Lines matter. (See Note 8 to the Financial Statements in the Company's Annual Report for the fiscal year ended December 31,1976).

Dividends

A dividend of 87½ cents a share on the Common Stock was declared October 20, payable December 5 to shareholders of record November 10.

Financial Statements

The accompanying condensed financial statements are unaudited, but in management's opinion they contain all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of financial position as of September 30, 1977 and 1976, the changes in financial position for the nine-month periods then ended, and the results of operations for the three-month and nine-month periods then ended.

Colin Stokes
Chairman

J. Paul Sticht
President

November 15, 1977

R. J. REYNOLDS INDUSTRIES, INC.

CONSOLIDATED SUMMARY OF OPERATIONS

(Dollars in Thousands Except Per Share Statistics)

	Three Months Ended September 30		Nine Months Ended September 30	
	1977	1976	**1977**	1976
Net sales and revenues (Note 2):				
Domestic tobacco	**$ 740,463**	$ 683,562	**$2,114,896**	$1,979,188
International tobacco	**321,412**	278,391	**938,142**	819,672
Transportation	**249,802**	226,425	**706,310**	626,959
Domestic petroleum	**114,916**	101,278	**410,093**	101,385
International petroleum (Note 9)	**108,240**	122,007	**381,969**	363,933
Foods and beverages	**62,406**	61,189	**213,030**	203,812
Aluminum products and packaging	**45,357**	40,779	**133,532**	117,631
Other (principally intercompany eliminations)	**(19,514)**	(16,224)	**(56,189)**	(46,103)
Consolidated	**$1,623,082**	$1,497,407	**$4,841,783**	$4,166,477
Earnings from operations (Note 3):				
Domestic tobacco	**$ 149,828**	$ 142,212	**$ 437,479**	$ 402,564
International tobacco	**22,446**	13,542	**67,609**	40,134
Transportation	**44,821**	43,838	**108,097**	96,669
Domestic petroleum	**(6,749)**	6,820	**5,558**	2,280
International petroleum (Note 9)	**6,733**	8,157	**12,010**	26,348
Foods and beverages	**5,740**	2,489	**16,879**	14,122
Aluminum products and packaging	**4,026**	2,646	**10,873**	8,630
Other (principally unallocated corporate expense)	**(7,240)**	(5,874)	**(20,524)**	(15,866)
Consolidated	**219,605**	213,830	**637,981**	574,881
Interest and debt expense	**(19,896)**	(21,713)	**(66,659)**	(46,878)
Other income (expense), net	**5,366**	(2,087)	**12,773**	4,771
	205,075	190,030	**584,095**	532,774
Foreign currency gains (losses):				
Realized	**(1,304)**	(1,266)	**(2,970)**	(2,725)
Unrealized	**(682)**	(9,128)	**1,318**	(13,608)
Earnings before provision for income taxes	**203,089**	179,636	**582,443**	516,441
Provision for income taxes (Note 4)	**99,592**	87,817	**290,846**	253,421
Net earnings	**103,497**	91,819	**291,597**	263,020
Less preferred dividends	**1,732**	2,552	**5,735**	7,810
Net earnings applicable to Common Stock	**$ 101,765**	$ 89,267	**$ 285,862**	$ 255,210
Net earnings per common share (Note 5):				
Primary	**$ 2.12**	$ 1.94	**$ 6.01**	$ 5.57
Fully diluted	**2.00**	1.80	**5.65**	5.15
Dividends per common share	**.82**	.77	**2.46**	2.31
Average number of common shares outstanding:				
Primary			**47,581,902**	45,786,986
Fully diluted			**51,634,344**	51,120,828

See Notes to Consolidated Condensed Financial Statements.

R. J. REYNOLDS INDUSTRIES, INC.

CONSOLIDATED CONDENSED BALANCE SHEETS

September 30
(Dollars in Thousands)

	1977	1976
ASSETS		
Current assets:		
Cash and short-term investments (Note 6)	**$ 104,523**	$ 112,505
Accounts and notes receivable, net	**546,297**	490,354
Inventories (Note 7)	**1,295,916**	1,320,332
Prepaid expenses	**33,863**	30,974
Total current assets	**1,980,599**	1,954,165
Property, plant and equipment — at cost	**2,906,500**	2,626,083
Less allowances for depreciation, depletion and amortization	**935,512**	791,433
Net property, plant and equipment	**1,970,988**	1,834,650
Cost in excess of net assets of businesses acquired	**165,661**	170,641
Other assets and deferred charges	**151,492**	256,811
	$4,268,740	$4,216,267
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable (Notes 11 and 12)	**$ 157,193**	$ 386,445
Accounts payable and accrued accounts	**544,263**	502,200
Current maturities of long-term debt (Note 13)	**32,890**	48,799
Income taxes accrued	**130,205**	141,276
Total current liabilities	**864,551**	1,078,720
Long-term debt (less current maturities) (Notes 12 and 13)	**790,332**	548,724
Other noncurrent liabilities	**70,386**	71,498
Deferred revenue (Note 10)	**7,627**	275,800
Deferred income taxes	**230,044**	184,424
Stockholders' equity (Notes 8 and 12):		
Preferred Stock	**32,445**	46,717
Common Stock	**240,545**	230,418
Paid-in capital	**145,539**	111,690
Earnings retained	**1,887,271**	1,668,276
Total stockholders' equity	**2,305,800**	2,057,101
	$4,268,740	$4,216,267

See Notes to Consolidated Condensed Financial Statements.

R. J. REYNOLDS INDUSTRIES, INC.

CONSOLIDATED CONDENSED STATEMENTS OF CHANGES IN FINANCIAL POSITION

Nine Months Ended September 30
(Dollars in Thousands)

	1977	1976
Working capital was provided by:		
Operations:		
Net earnings	**$291,597**	$ 263,020
Depreciation, depletion and amortization	**173,856**	101,456
Deferred income taxes	**37,544**	(8,740)
Long-term foreign currency translation (gains) losses	**3,368**	9,959
Other	**(10,916)**	3,230
Total from operations	**495,449**	368,925
Proceeds from long-term debt (Note 12)	**156,816**	7,524
Deferred revenue from sale of oil and gas production (Note 11)	**—**	280,000
Proceeds from issuance of Company's stock	**39,080**	14,450
Reclassification of current maturities of long-term debt (Note 13)	**15,799**	—
Other (principally disposals of property, plant and equipment)	**24,872**	10,936
	732,016	681,835
Working capital was used for:		
Net increase in long-term assets from acquisition accounted for as a purchase (Note 11)	**—**	495,116
Capital expenditures	**210,505**	107,351
Cash dividends	**122,848**	113,533
Long-term debt becoming currently payable	**40,571**	31,015
Retirement of Preferred Stock upon conversion	**12,162**	4,529
Cost of treasury shares purchased	**2,151**	697
Reduction in deferred revenue (Note 10)	**255,694**	12,137
Other (principally other assets and deferred charges)	**383**	24,949
	644,314	789,327
Increase (decrease) in working capital	**$ 87,702**	$(107,492)

See Notes to Consolidated Condensed Financial Statements.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Note 1
Accounting Change

During 1977 the Company changed its method of accounting for leases in conformity with the requirements of Statement No. 13 published by the Financial Accounting Standards Board in November 1976. All prior periods have been restated to reflect this change. The change had no material effect on assets, liabilities or net earnings.

Note 2
Excise Taxes

Net sales and revenues include excise taxes on tobacco and petroleum products as indicated in the following table:

(Dollars in Thousands)

	Three Months Ended September 30		Nine Months Ended September 30	
	1977	1976	**1977**	1976
Domestic tobacco	**$221,728**	$220,468	**$ 639,769**	$ 637,886
International tobacco	**170,253**	155,532	**491,101**	443,743
Domestic petroleum	**3,342**	5,057	**10,317**	5,057
	$395,323	$381,057	**$1,141,187**	$1,086,686

Note 3
Costs and Expenses

For interim reporting purposes, certain costs and expenses are charged to operations in proportion to the estimated total annual amount expected to be incurred.

Note 4
Income Taxes

The provision for income taxes includes both amounts due currently and amounts that are deferred and that may be payable in future years. The provision for deferred income taxes amounted to $16,005,000 and $(13,536,000) for the three months ended September 30, 1977 and 1976, respectively, and $37,544,000 and $(8,740,000), respectively, for the nine-month periods then ended.

Note 5
Earnings Per Share

Primary net earnings per common share are determined by dividing net earnings applicable to Common Stock by the average number of common shares and equivalent common shares outstanding.

Fully diluted earnings per common share are calculated using the "treasury stock" method. This method assumes that all shares of the Preferred Stock outstanding during the period were converted into Common Stock and the proceeds used to purchase treasury common shares at the higher of the average daily price or period-end closing price of the Common Stock.

Note 6
Cash and Short-Term Investments

Short-term investments at September 30, 1977 and 1976, valued at cost (approximate market), amounted to $4,641,000 and $6,398,000, respectively.

Note 7
Inventories

The major classes of inventory and the amount of each at September 30 were:

	(Dollars in Thousands)	
	1977	1976
Leaf tobacco	**$ 945,604**	$ 973,144
Manufactured products	**108,957**	94,963
Excise tax on manufactured products removed from bond	**81,493**	76,198
Petroleum products	**31,691**	31,160
Other materials and supplies	**128,171**	144,867
	$1,295,916	$1,320,332

Note 8
Common and Preferred Stock

During the third quarter of 1977, 70,618 shares of the Company's $2.25 Convertible Preferred Stock (without par value), stated value of $10.57, were converted into 105,922 shares of Common Stock (par $5). Of the authorized but unissued common shares (60,000,000 shares authorized; 48,108,940 and 46,083,631 shares outstanding at September 30, 1977 and 1976, respectively) 4,604,304 shares were reserved for issuance upon conversion of 3,069,536 shares of $2.25 Convertible Preferred Stock (authorized 3,081,486 and 4,431,701 shares; outstanding 3,069,536 and 4,419,751 shares at September 30, 1977 and 1976, respectively).

Note 9
Contingent Matters

During the three months ended September 30, 1977, except as noted below, there have been no significant developments with respect to pending or threatened litigation, commitments or other contingencies (including those referred to in Note 8 to the Financial Statements in the Company's Annual Report for the fiscal year ended December 31, 1976, and Note 9 to the Consolidated Condensed Financial Statements in the Company's Quarterly Reports for the quarters ended March 31, 1977, and June 30, 1977) which, in management's opinion would have a material effect on the Company's financial statements.

On September 19, 1977, the Government of Kuwait issued a decree nationalizing the assets of American Independent Oil Company (AIOC), a wholly owned subsidiary of the Company, in that country and in the Divided Zone between Kuwait and Saudi Arabia, effective immediately. The principal assets were a concession in the Divided Zone which had been producing during 1977 an average of approximately 90,000 barrels per day of crude oil and which had been otherwise scheduled to expire in June, 2008, and a refinery and desulfurization plant and related facilities (including a five-million barrel oil terminal) in Kuwait. The book value of the assets is not material to the Company and its subsidiaries as a whole.

For the year ended December 31, 1975, net sales attributable to the nationalized assets were approximately $251,753,000, as compared with approximately $303,516,000 for the year ended December 31, 1976, and $187,744,000 for the six months ended June 30, 1977. Earnings from operations (earnings before interest and debt expense, other income and expense and provision for income taxes) were approximately $80,660,000 for the year ended December 31, 1975, $34,753,000 for the year ended December 31, 1976, and $6,284,000 for the six months ended June 30, 1977. In 1976, the Company reclassified to operating

expense that part of Kuwait taxes on petroleum income which was in excess of the customary corporate income tax rate in Kuwait. In recent years, earnings from operations have been decreasing principally because of provisions for higher royalty and tax assessments by the Government of Kuwait. Consequently, the Company does not foresee any material adverse effect on its earnings as a result of the nationalization.

The decree provides, among other things, for the formation of a committee to assess compensation due to and obligations of AIOC. The obligations may include royalties, income taxes, termination benefits and other items. According to a report appearing in a recent publication, Kuwait is claiming approximately $74,000,000 in tax and royalties, and it is possible that the amount of the obligations may exceed the compensation, if any, as ultimately determined by the committee or otherwise.

In light of the uncertainties involved, the amount of any ultimate gain or loss, as the case may be, is indeterminable at this time. However, the Company presently believes that the resolution of the foregoing will not have a material adverse effect on the financial position of the Company and its subsidiaries.

Note 10
Deferred Revenue — Oil Production Payment

In September 1977 the Company repurchased the approximate $200 million remaining balance of the production payment previously sold to a group of banks as part of the financing of an acquisition. (See Note 11 to these Consolidated Condensed Financial Statements).

Note 11
Acquisition

On June 30, 1976, the Company acquired the outstanding capital stock of the principal U.S. subsidiaries of the Burmah Oil Company, Limited for approximately $522 million in cash. The consolidated operating results of the Company include the operations of the acquired companies from the date of acquisition.

The acquisition was financed initially by short-term borrowings, which were subsequently replaced by the sale in September 1976 of a $280 million nonrecourse production payment (see Note 6 to the Financial Statements in the Company's Annual Report for the fiscal year ended December 31, 1976), $100 million in 8.9% long-term notes issued in October 1976, and by funds received as described in Note 12 to these Consolidated Condensed Financial Statements.

Note 12
Issuance of Long-Term Debt and Secondary Offering of Common Stock

On April 13, 1977, the Company issued $150,000,000 principal amount of 8% Sinking Fund Debentures. On April 14, 1977, pursuant to a registered underwritten secondary offering, certain underwriters acquired from a stockholder of the Company 600,000 shares of Industries' $2.25 Convertible Preferred Stock. The Preferred Stock was converted by the underwriters into 900,000 shares of Industries' Common Stock which was offered to the public. Upon conversion, $13,200,000 was received from the underwriters.

Of the net proceeds received by Industries in respect to the foregoing, $140,000,000 was used for reduction of Notes Payable, with the balance being used for working capital and other corporate purposes.

Note 13
Subsequent Event

In November 1977 the Company signed an agreement to replace approximately $150 million of long-term debt (payable in deutsche marks) with $160 million in 7½% five-year notes (payable in U. S. dollars). Accordingly, the current portion of the deutsche mark debt has been classified as long-term debt at September 30, 1977.

Inquiries

Communications concerning transfer requirements and lost certificates should be directed to either Transfer Agent: The Chase Manhattan Bank, N.A., 1 New York Plaza, 14th Floor, New York, N. Y. 10015, or First Jersey National Bank, 2 Montgomery St., Jersey City, N.J. 07303.

Communications concerning dividends and change of address should be directed to R.J. Reynolds Industries, Inc., Shareholder Services Dept., Box 2959, Winston-Salem, N.C. 27102.

Board of Directors

JOSEPH F. ABELY, JR.
WILLIAM S. ANDERSON
C. F. BENBOW
ALBERT L. BUTLER, JR.
HERSCHEL H. CUDD
GORDON GRAY
WM. D. HOBBS
WALTER L. LINGLE, JR.
JOHN D. MACOMBER
MICHAEL R. McEVOY
CHARLES F. MYERS, JR.
JAMES R. PETERSON
H. C. ROEMER
J. PAUL STICHT
COLIN STOKES
J. DWAYNE TAYLOR
J. TYLEE WILSON

Officers

COLIN STOKES
Chairman and Chief Executive Officer

J. PAUL STICHT
President and Chief Operating Officer

JOSEPH F. ABELY, JR.
Executive Vice President and
Chief Financial Officer

MICHAEL R. McEVOY
Executive Vice President

JAMES R. PETERSON
Executive Vice President

J. DWAYNE TAYLOR
Executive Vice President

J. TYLEE WILSON
Executive Vice President

C. F. BENBOW
Senior Vice President and Secretary

RODNEY E. AUSTIN
Vice President

DENNIS DURDEN
Vice President

E. C. RITCHELL
Vice President

H. C. ROEMER
Vice President and General Counsel

R. D. THOMPSON
Vice President

J. W. DOWDLE
Treasurer

J. A. HAGAN
Comptroller

Admiring the silver globe trophy given to Stanford University in the R.J. Reynolds Industries, Inc. Awards for Excellence in Business Education are (from left) Colin Stokes, RJR chairman; Arjay Miller, dean of Stanford's graduate school of business; and J. Paul Sticht, RJR president.

RJR honors business schools

Stanford University and Cornell University have been named winners in the first annual R.J. Reynolds Industries, Inc. Awards for Excellence in Business Education.

Stanford was honored for having the best program for a master's degree in business administration, based on the 1977 results of a yearly MBA magazine poll of the deans of the nation's leading business schools.

Cornell was judged to have the most improved MBA program, according to the poll.

Stanford and Cornell each were presented with a $25,000 check by Reynolds Industries Chairman Colin Stokes at a formal awards dinner in New York.

Stanford also received a silver globe trophy, that will travel each year to the school with the best MBA program. Stanford has won top rating each year since the MBA magazine poll was formed in 1974.

R.J. Reynolds created the awards program this year so that the "spirit of competition can benefit the business schools by further stimulating the pursuit of excellence," said Company President J. Paul Sticht, who announced the winners at a press gathering prior to the dinner.

Aromatics brings out new essential oil line

Aromatics International, an R. J. Reynolds Industries, Inc. subsidiary which produces flavors and fragrances, has developed a new line of artificial essential oils for foods and related industries.

The new artificial oils have been developed as a one-to-one replacement for natural oils, and offer substantial cost savings.

Leading uses for the artificial oils will be in spicing compounds, candies, gum, toothpaste, mouthwashes and tobacco.

R.J. Reynolds Tobacco tests three new products

Three new products, each pegged for a closely defined market, have been introduced into test recently by R.J. Reynolds Tobacco Company.

The new entries are Camel Lights cigarettes, which extend the Camel heritage of flavor and taste to the low "tar" market; Salem King Size cigarettes, also with reduced "tar" content; and Work Horse pouch chewing tobacco.

Camel Lights, containing 9mg "tar" and 0.8mg nicotine, are being tested in Dallas, Fort Worth, Amarillo, Kansas City, Des Moines and Springfield, Mo.

The new Salem brand extension, containing 16mg "tar," is being tested in Atlanta and Memphis.

The Tobacco Company estimates that low "tar" cigarettes will account for over 22 percent of all cigarettes sold in 1977, and continued growth is predicted for the category. Reynolds Tobacco holds 40 percent of the low "tar" market, compared to 33 percent of the total U.S. cigarette market.

Work Horse chewing tobacco went on sale in October in Winston-Salem, Charlotte, Raleigh, Cincinnati, Columbus, Tulsa, Little Rock, and Fort Smith, Ark.

Work Horse, believed to be the most thoroughly researched and consumer-tested chewing brand ever introduced, stresses longer-lasting flavor and good tobacco taste.

Chewing tobacco sales have risen 63 percent over the last decade to 56 million pounds of pouch tobacco in 1976. Reynolds Tobacco leads the industry in the sale of plug chewing tobacco with such brands as Days Work and Apple.

Sea-Land delivers Alaska pipeline oil

The first barrel of Alaskan pipeline oil to reach the continental United States arrived aboard a Sea-Land Service, Inc. containership in Seattle.

The RJR shipping subsidiary called on its SS GALVESTON containership to carry the red, white and blue oil drum on its seven-day voyage from Anchorage. The oil had been transported over-the-road to Anchorage from Valdez, the southernmost point of the pipeline.

Sea-Land has served Alaska since 1964, delivering much of the drilling equipment and consumer goods needed during the pipeline construction.

RJR
Quarterly
Report 3

Third Quarter 1977

Published quarterly by R.J. Reynolds Industries Inc., Box 2959, Winston-Salem, N.C. 27102.